

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RELIANCE CAPITAL HOTELS CORPORATION	:	DETERMINATION
	:	DTA NO. 813647
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, Reliance Capital Hotels Corporation, c/o Reliance Group Holdings, Inc., 55 East 52nd Street, New York, New York 10055, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on January 18, 1996 at 1:15 P.M. Petitioner filed its brief on March 11, 1996. The Division of Taxation filed its brief on March 26, 1996. Petitioner filed its reply brief on May 6, 1996, which date began the six-month period for the issuance of this determination. Petitioner appeared by Richard B. Friedman, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Susan Hutchison, Esq., of counsel).

ISSUE

I. Whether petitioner transferred an interest in real property as defined in Tax Law § 1440(4).

II. Whether the transfer at issue was "pursuant to" a contract entered into before March 31, 1983 and was therefore exempt from gains tax pursuant to Tax Law § 1443(6).

III. Whether certain other entities and not petitioner are properly liable for gains tax which may be due and owing with respect to the subject transfer.

IV. Whether petitioner's former stockholder is properly liable for any gains tax due and owing.

FINDINGS OF FACT

1. On May 4, 1982, a joint venture comprised of petitioner, Reliance Capital Hotels Corporation, and Taxfinco, Inc. ("Taxfinco") (an unrelated entity) entered into a purchase and sale agreement (the "Contract") with Providence Capital Realty Group, Inc. ("PCRG"), pursuant to which PCRG agreed to sell approximately 7.78 acres of land ("the Land") in Westbury, New York to petitioner and Taxfinco.

2. On July 30, 1982, PCRG assigned its interest in the Land to a related entity, F.O. Building Associates ("FOB").

3. On December 28, 1983, FOB gave a mortgage on the Land to The Capitol Life Insurance Company ("Capitol Life"), another entity related to PCRG.

4. By letter dated June 17, 1985, PCRG and FOB (as assignee) gave notice to petitioner and Taxfinco that it was terminating the Contract and tendered a check representing the buyers' \$130,000.00 deposit plus interest thereon.

5. On August 16, 1985, FOB, Westbury Properties Group¹ and Capitol Life, as sellers, entered into a contract ("the Westbury Contract") to sell the Land and certain other parcels of property to Westbury Property Sales Associates and Westbury Property Investment Company (collectively, "Westbury").

6. The Westbury Contract specifically provided that Westbury had been advised of the existence of the Contract and that Westbury had agreed to accept title to the Land "subject to the rights, if any, of [petitioner and Taxfinco]".

7. By letter dated August 26, 1985, Taxfinco rejected the termination of the Contract by PCRG and FOB and returned the check representing the buyers' deposit plus interest which had been tendered with the proposed termination.

¹Westbury Properties Group, a limited partnership, apparently had an ownership interest in the other parcels which were the subject of the Westbury Contract. It did not have an ownership interest in the Land.

8. On October 9, 1985, petitioner and Taxfinco commenced an action in the Supreme Court of the State of New York, County of Nassau, against PCRG and FOB alleging breach of the Contract ("the Action"). In its complaint petitioner alleged that PCRG had not validly terminated the Contract. Also on October 9, 1985, petitioner and Taxfinco caused a notice of pendency to be filed in the office of the County Clerk of Nassau County.

9. By deed dated October 22, 1985, FOB transferred the Land to Westbury.

10. In a supplemental complaint dated March 31, 1986, petitioner and Taxfinco added Westbury as a defendant in the Action. The supplemental complaint alleged that Westbury had actual or constructive notice of the Action prior to its purchase of the Land and sought specific performance of the Contract or money damages.

11. The plaintiffs and the defendants in the Action brought motions and cross-motions for summary judgment. By order dated March 13, 1987, the court denied the motions for summary judgment brought by both the plaintiffs and the defendants. With respect to the defendants' motion, the court noted that, by personally delivering the June 17, 1985 letter to the buyers (see, Finding of Fact "4" herein), the defendants had failed to comply with the notice provisions of the Contract, thereby rendering the notice of termination of the Contract a "nullity". The court therefore denied the defendants' motion.

12. On or about October 23, 1987, an agreement was reached to settle the Action. Under the terms of the settlement, general releases were exchanged among the parties and Westbury paid the joint venture a total of \$1,175,000.00, attributable as follows: \$500,000.00 to Taxfinco and \$675,000.00 to petitioner.

13. In a letter addressed to the attorneys for petitioner and Taxfinco and dated October 23, 1987, the attorney for Westbury set forth his understanding of the settlement agreement as follows:

"[T]his is to confirm that defendant [Westbury] has offered payment of \$1,175,000 in settlement of the [Action] and that you [i.e., the joint venture] have accepted same.

You have agreed that in connection therewith (i) the [A]ction shall be discontinued as to all defendants with prejudice, (ii) the related lis pendens shall be lifted promptly upon payment, and (iii) there shall be an exchange of releases

between plaintiffs and defendants from all claims related to the subject matter of the [A]ction . . .

You have stated that you recognize too that this payment is in full satisfaction of all such claims . . ."

14. On April 14, 1988, a Certificate of Dissolution of petitioner dated March 31, 1988 by written consent of its sole shareholder, Reliance Capital Corporation, was filed in the office of the Secretary of State of Delaware.

15. Except to the extent that the \$100.00 of capital of petitioner was to have been distributed to its sole shareholder upon dissolution, no dividends or other monies were distributed to petitioner's parent by petitioner at the time of or as part of its dissolution.

16. The Division of Taxation ("Division") subsequently undertook an audit of petitioner. Following the audit, the Division concluded that the exchange of the general release and the \$1,175,000.00 payment constituted a transfer of an interest in real property subject to the gains tax, and on August 23, 1993, the Division issued to petitioner a Notice of Determination which assessed real property transfer gains tax in the amount of \$117,500.00, plus penalty and interest.

17. Pursuant to a Conciliation Order dated December 9, 1994, the gains tax deficiency was reduced to \$58,501.00, plus interest. Penalty on the assessment was cancelled.

18. The gains tax assessment as revised by the Conciliation Order was calculated based upon consideration of \$675,000.00 (i.e., the settlement payment by Westbury to petitioner) less an original purchase price allowance of \$89,990.00, for a gain subject to tax (at a 10 percent rate) of \$585,010.00.

19. Petitioner submitted proposed findings of fact numbered "1" through "13". Such proposed findings are accepted and have been incorporated into the Findings of Fact herein with the following exception: Proposed finding of fact "4" states that the notice of termination given by PCRG to petitioner and Taxfinco was given "in accordance with the notice provisions of the Contract." Since it appears that the notice of termination failed to meet the notice requirements of the Contract (see, Finding of Fact "11"), this quoted portion of proposed Finding of Fact "4" is rejected.

CONCLUSIONS OF LAW

A. Article 31-B of the Tax Law, which became effective March 28, 1983, imposes (under Tax Law § 1441) a tax at the rate of 10% on gains derived from certain transfers of real property within New York State.² Tax Law § 1440(7) defines "transfer of real property" as "the transfer . . . of any interest in real property by any method, including. . . sale, exchange, assignment, [or] surrender." Additionally, Tax Law § 1440(4) provides in relevant part that "[i]nterest' when used in connection with real property includes . . . an option or contract to purchase real property."

B. Petitioner asserts that the payment to petitioner by Westbury was not a payment for an interest in real property. Petitioner notes that Westbury already held title to the property at the time of the settlement payment. Moreover, petitioner asserts that Westbury merely settled the Action to obtain financing and to avoid delay in the development of the Land. Petitioner thus asserts that the settlement payment was not properly subject to gains tax.

Whether a settlement payment is properly subject to gains tax depends upon the "origin and character" of the underlying claim (see, Preferred Rentals, Stockton Building, Inc., Tax Appeals Tribunal, March 21, 1996). Pursuant to the following discussion, it is concluded that the origin and character of the joint venture's claim in the Action, along with the payment in settlement thereof, constituted a transfer of an interest in real

property pursuant to the language of Tax Law § 1440(4) and (7), and was properly subject to tax under Tax Law § 1441.

Although the record contains evidence supportive of petitioner's claim that the Contract was terminated on June 17, 1985, i.e., the termination notice itself and the subsequent transfer of the deed to Westbury, such evidence is clearly outweighed by other facts in the record indicating that the termination was not valid and that the Contract remained in effect until the

²Article 31-B has been repealed with respect to transfers occurring on or after June 15, 1996; it remains in effect with respect to transfers occurring prior to that date (see, L 1996, ch 309, § 180).

time of the settlement payment. Specifically, the joint venture rejected the proposed termination and commenced the Action alleging the validity of the Contract and seeking, inter alia, specific performance. Moreover, although PCRG contracted to sell the Land to Westbury following the purported termination, the Westbury Contract explicitly noted the joint venture's claims and that Westbury was taking title to the Land subject to such claims. Consequently, although FOB transferred the Land to Westbury by deed on October 22, 1985, Westbury was aware of the cloud on its title created by the Action. Also indicative that the Contract was not terminated and that it was in effect until the settlement payment is the court's denial of the summary judgment motion which found the purported termination to be a nullity. Finally, the settlement payment itself, a payment of \$1,175,000, indicates that the joint venture had rights under the Contract.

The foregoing facts indicate that petitioner and Taxfinco had a valid contract to purchase real property until the settlement payment in October 1987. Such facts, along with the terms of the settlement as outlined in the letter of Westbury's attorney, dated October 23, 1987 (see, Finding of Fact "13"), establish that the payment to petitioner was for petitioner's relinquishment of such rights.

The record herein is thus clear in establishing that the "origin and character" of the joint venture's claim in the Action was that it had a right under the Contract to purchase the Land. Under the gains tax, the joint venture thus claimed an interest in real property (Tax Law § 1440[4]), and the payment in settlement of the claim constituted consideration for the surrender of an interest in real property. Such an exchange constitutes a transfer of real property within the meaning of Tax Law § 1440(7). The payment to petitioner was therefore properly subject to tax under Tax Law § 1441.

C. Alternatively, petitioner seeks an exemption from the tax imposed by Tax Law § 1441 under the "grandfathered contract exemption" set forth in Tax Law § 1443(6) as follows:

"Where a transfer of real property occurring after the effective date of this article is pursuant to a written contract entered into on or before the effective date of this article, provided that the date of execution of such contract is confirmed by independent evidence, such as recording of the contract, payment of a deposit or

other facts and circumstances as determined by the tax commission. A written agreement to purchase shares in a cooperative corporation shall be deemed a written contract for the transfer of real property for the purposes of this subdivision." (Emphasis supplied.)

D. Preliminarily, it should be noted that, as Tax Law § 1443(6) authorizes an exemption from the gains tax, this statute should be strictly construed against petitioner (Matter of Old Nut Co. v. New York State Tax Commn., 126 AD2d 869, 871, lv denied 69 NY2d 609, 516 NYS2d 1025; Matter of Saratoga Harness Racing v. New York State Tax Commn., 119 AD2d 919, 501 NYS2d 200, lv denied 68 NY2d 610, 508 NYS2d 1027), since an exemption is not a matter of right but is allowed only as a matter of legislative grace (Matter of Grace v. State Tax Commn., 37 NY2d 193, 371 NYS2d 715, 719).

E. Petitioner has clearly failed to establish entitlement to the grandfathered contract exemption to the gains tax. Specifically, the transfer upon which the Division assessed gains tax herein occurred on or about October 23, 1987. In order to qualify for the exemption petitioner must show that this transfer was "pursuant to" the Contract entered into on May 4, 1982. Clearly, the record indicates otherwise. The Contract provided for the sale of the Land from PCRG to petitioner and Taxfinco for consideration. The transfer upon which gains tax was assessed was a relinquishment of petitioner and Taxfinco's rights under the Contract in exchange for \$1,175,000.00. That the subject transfer was not made "pursuant to" the Contract is obvious. Under the May 4, 1982 Contract, petitioner contracted to purchase an interest in real property; in the transfer at issue, petitioner, in the position of a seller, transferred an interest in real property (as defined in Tax Law § 1440[4]) for consideration. Additionally, Westbury, which paid for the releases of petitioner and Taxfinco in the subject transfer, was not even a party to the Contract. Clearly, the later transfer was not made "pursuant to" the Contract and the grandfather exemption is not applicable.

Additionally, it is noted that petitioner's assertion that the Division admitted in its answer that the monies paid to petitioner by Westbury were paid under the Contract is erroneous. The answer asserts the Division's position that the subject payment was made by Westbury "in connection with the release and/or assignment of [Taxfinco's and petitioner's] rights under [the

Contract]." As correctly noted by the Division in its brief, this statement is not an admission that the subject payments were made "pursuant to" the Contract within the meaning of Tax Law § 1443(6).

F. Petitioner also asserts that only PCRG, FOB and/or Westbury can be liable for any gains tax due because the only transfers of the Land occurred when PCRG assigned its interest in the Land to FOB and when FOB sold the land to Westbury. Petitioner's assertion fails to recognize the expansive definition of an "interest in real property" under Article 31-B, and is therefore without merit. As noted above, Article 31-B defines an "interest in real property" to include contracts to purchase real property (Tax Law § 1440[4]). As discussed above, petitioner transferred such an interest for consideration, thereby giving rise to gains tax liability.

G. Petitioner also contends that, even if it were responsible for the gains tax herein, petitioner could not pay such tax because it has been dissolved. Petitioner further asserts that the relevant issue is whether petitioner's former stockholder could be liable for any gains tax.

As to whether petitioner could pay any tax found due herein, it is noted that the Division of Tax Appeals' function in this case is limited to determining liability for tax (see, Tax Law § 1441[1]). The Division of Tax Appeals is not involved in the collection or collectability of tax determined to be due. As to the liability of petitioner's former stockholder, inasmuch as neither a notice of determination nor petition exist for said stockholder, the Division of Tax Appeals has no jurisdiction to consider the liability of such former stockholder (see, Tax Law §§ 1444[1], 2008).

H. The petition of Reliance Capital Hotels Corporation is denied and the Notice of Determination dated August 23, 1993, as modified by the Conciliation Order dated December 9, 1994, is sustained.

DATED: Troy, New York
October 31, 1996

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE